TEACHERS' RETIREMENT BOARD

SUBCOMMITTEE CORPORATE GOVERNANCE

SUBJECT: Corporate Pension Reporting	ITEM NUMBER: 5
	ATTACHMENTS: 1
ACTION: ____	DATE OF MEETING: October 2, 2002
INFORMATION: X	PRESENTER: Christopher J. Ailman

Executive Summary:

In July, the honorable Dr. Kathleen Connell, State Controller, expressed her concern over the pension plan assumption rates used by corporations. Dr. Connell requested that CalSTRS review the matter and discuss her concerns at the October meeting. Attachment 1 is a letter and packet, from Dr. Connell presenting information and outlining the issue. According to data collected by Pensions and Investments magazine, 24 of the top 100 corporate pension plans have actuarial assumed interest rates at or above 10 percent. Public pension surveys performed by Cost Effectiveness Measurement (CEM) and by Greenwich Associates, show that public pension plans are densely clustered at an eight percent actuarial assumed investment earning rate.

KATHLEEN CONNELL

Controller of the State of California

To: CalSTRS Board Members September 17, 2002

From: Dr. Kathleen Connell

Subject: Corporate Pension Asset Rate of Return Assumptions

Fellow Board Members,

Perceived accounting gimmicks and a lack of transparency in the financial statements issued by corporate America have shaken investor confidence in the public equity markets. I am particularly disturbed by the recognition of income derived from pension plan assets to inflate corporate earnings. Many public corporations are using inflated expected rates of return on pension assets to pad the corporate bottom line. Income derived from pension assets is not available to the corporation for use in operations and does not reflect how successfully a corporation is managing its core business. By padding earnings with this income, corporations are being less than truthful about the performance of their core business operations.

In an effort to bolster our leadership role in championing financial reporting transparency, I am recommending that we take the following actions:

- CalSTRS should include analysis of a company's projected return on pension assets when making future investment decisions;

- Staff should communicate with companies in which CalSTRS is currently a shareholder to express concern with overly aggressive projections for rate of return on pension assets;

- Staff should communicate directly with the FASB to express concern with the lack of transparency in the reporting of pension income allowed by current accounting standards;

- Staff should encourage the FASB to provide guidance to corporations in establishing their projected rates of return on pension assets.

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ISSUE:

Many companies are projecting returns on pension assets that are far too aggressive given the outlook for muted returns in the equity markets. Excessive return assumptions allow companies to report inflated income derived from pension assets on their financial statements, per accepted accounting standards. Pension income is included in companies' reported Net Income / Earnings numbers, though pension income is not available to a company for operational purposes. Companies are required to provide the impact on earnings attributable to pension income in the Notes section of the financial statements. Thus, two issues exist:

1) Companies that employ overly aggressive return projections for pension assets are artificially inflating Net Income / Earnings numbers.

2) Current accounting standards allow for lack of transparency in reporting income from operations when pension income is included, though not available to a company for operational purposes.

ACTIONS FOR CONSIDERATION:

CalSTRS should include analysis of a company's projected return on pension assets when making future investment decisions. Corporate governance staff should also communicate with companies in which CalSTRS is currently a shareholder to express concern with overly aggressive projections for rates of return on pension assets.

The issue of transparency is specific to financial reporting allowed by current accounting standards. As such, staff should communicate directly with the FASB to express concern with the lack of transparency allowed by current accounting standards with respect to reporting of pension income. Staff should also encourage the FASB to provide guidance to corporations in establishing their projected rates of return on pension assets.

ARTICLES:

- Pensions & Investments (July 8, 2002) – "Inside Annual Reports; Most return assumptions not dropping with bear market"
- Pensions & Investments (August 19, 2002) – "Rosy Assumptions; Beware of 'pension time bomb,' Connell tells funds"
- Financial Times (August 30, 2002) – "Pension funds may act on over inflated returns"
- USA Today (September 5, 2002) – "Pension revenue can mislead investors"
- Los Angeles Times (September 5, 2002) – "Pensions straining civic coffers"
- Milliman executive summary – Study of 50 largest U.S. corporate pension plans

Pensions and Investments

July 8, 2002, Monday

SECTION: Pg. 3

LENGTH: 1299 words

HEADLINE: INSIDE ANNUAL REPORTS; Most return assumptions not dropping with bear market

BYLINE: Adin Bookbinder

BODY:

Eight of 100 companies surveyed by Pensions & Investments raised their pension funds' assumed long-term rates of return last year, despite the bear market, while only 16 lowered their assumptions.

As the stock market was delivering negative returns for the second year in a row, dropping the three-year compound annual return to -1%, SBC Communications Inc., San Antonio, Texas, raised its pension fund rate of return assumption by 100 basis points to 9.5%.

SBC raised this rate despite reporting a loss on investments of almost $3 billion in 2001. However, the plan has achieved a 10-year annualized return of more than 10% - a rationale the company felt compelled to state in the text of its annual report.

Alcoa Inc., Pittsburgh, and John Hancock Financial Services Inc., Boston, each raised its assumption by 50 basis points to 9.5%. Goodyear Tire & Rubber Co., Akron, Ohio, raised its assumption 50 basis points to 10% and Consolidated Edison Inc., New York, raised its return assumption 70 basis points to 9.2%.

Con Edison increased its assumption because it had earned returns in the midteens for several years, said Robert Stelben, vice president and treasurer. The benefit obligation increased in 2001, meanwhile, and plan assets dropped as the fund booked losses on investments for both 2001 and 2000. Still, said Mr. Stelben, ''two years doesn't make a lifetime.''

Biggest cut

Among the companies that reduced their rate of return assumptions, ChevronTexaco Corp., San Francisco, made the biggest cut, 120 basis points to 8.8% from 10%. AK Steel Corp., Middleton, Ohio; Weyerhaeuser Co., Federal Way, Wash.; Sprint Corp., Overland Park, Kan.; Walt Disney Co., Burbank, Calif.; and Sears, Roebuck & Co., Hoffman Estates, Ill., all reduced their return assumptions by 50 basis points.

Weyerhaeuser's cut still left its return assumption at 11%, the highest for any company examined.

ChevronTexaco adjusts its rate of return assumption quarterly because it ''wants to reflect reality,'' said David Smay, general manager of benefit plan investments. Executives do not think 10% or 9.5% returns are realistic expectations, Mr. Smay said, and ''we'll be delighted if we can get 8% (returns) on the whole portfolio.''

Among the 100 largest corporate plans, the average expected rate of return was 9.3% and the median was 9.5%, P&I found. Almost a quarter of the plans examined had even more optimistic rates - between 10% and 11%. Three-quarters of the 100 plans made no change to their interest rate assumptions from 2000 to 2001.

All but five of the nation's 100 largest corporate plans had negative returns on their plan assets in 2001. Still, eight of the 10 largest plans reported pension surpluses. Forty-eight plans had obligations exceeding their assets in 2001; of these plans, only 17 were underfunded in 2000.

At Viacom Inc., New York, investments on plan assets netted $190.3 million. General Dynamics Corp., Falls Church, Va., had a return of $80 million on its pension assets, Alcoa's plan gained $65 million, and First Energy Corp., Akron, Ohio, recorded $8.1 million. And Fort Worth, Texas-based American Airlines Inc., in a year especially cruel to the major domestic airlines, earned $1 million on its pension assets.

The companies with the largest pension surpluses in dollar terms were General Electric Co., Stamford, Conn., $14.6 billion; Verizon Communications Inc., New York, $12.2 billion; and SBC, $7.7 billion. All three used a 9.5% rate of return assumption, although GE and Verizon offset this somewhat with high salary increase assumptions of 5%.

In terms of plan assets as a percentage of benefit obligations, the best funded plans were those of Kaiser Permanente, Oakland, Calif., 245%; Sandia National Laboratories, Albuquerque, N.M., 204.9%; FPL Group Inc., Juno Beach, Fla., 188.2%; and GE, 147.9%.

Unfunded liabilities

Among the plans with the largest unfunded liabilities in dollar terms were General Motors Corp., New York, with $9.1 billion; ExxonMobil Corp., Irving, Texas, $2.8 billion; UAL Corp., Chicago, $2.5 billion, Delphi Automotive Systems Corp., Troy, Mich., $2.4 billion; and Delta Air Lines Inc., Atlanta, $2.35 billion.

Arlington, Va.-based U.S. Airways Inc. had the worst funding status in terms of assets as a percentage of benefit obligation: 57.3%. It was followed by Northwest Airlines Inc., St. Paul, Minn., and ExxonMobil, both with assets equal to only 65.9% of obligations.

In a year of economic downturn and dismal market performance, to count on investment returns of 9% or higher would seem like wishful thinking - but it is not an invitation for disaster, said Adam Reese, a senior consultant in the Arlington, Va., office of the Hay Group.

Pension funds calculate their rates using ''a slightly higher inflation base than we're experiencing currently,'' Mr. Reese said, but they are considering a long period of time. Over the last five years, he said, most plans have returned better than 9.3%. And most plans, he added, still are drawing on unrecognized gains from the boom years of 1998 and 1999 to temper last year's losses.

The market in 2001 took a toll on General Motors' funding of its defined benefit plans. The company, which had $67 billion in pension assets and used a 10% expected rate of return on plan assets in 2001, saw $4.4 billion in pension assets disappear as it reported a -5.7% return on assets.

In contrast, in 2000 the company reported pension income of $634 million and had a funding surplus.

GM made no change to its 2001 interest rate assumption, however, because during any 10-year period over the past 15 years, the plan averaged more than a 10% return on its assets, said Jerry Dubrowski, a GM spokesman.

According to several actuaries, under Financial Accounting Standard 87, companies are permitted to report the average market value of their pension assets over a maximum period of five years. Most controversially, they also are allowed to include their net pension earnings in their net corporate earnings, encouraging overly optimistic pension accounting and potentially disguising the true health of a company, the actuaries said. A higher expected rate of return on pension assets decreases the benefit cost and raises the corporate bottom line.

''FAS 87 invites corporations to set up an artificial profit production factory,'' said Keith Ambachtsheer, president of K.P.A. Advisory Services Ltd., Toronto. ''Corporations can assume anything they want.''

Larry Bader, a retired actuary, formerly of William M. Mercer Inc., New York, concurs: ''If you asked an automaker to report their expected sales, would you think they would go low or high?''

Pension income

Of the companies examined, several of those using above-average return assumptions also reported pension income as a significant part of their net income. Weyerhaeuser, with its 11% expected rate of return on plan assets, reported pension income of $234 million - 66% of the net corporate income. (The average contribution of net pension income to net corporate income was 12%, P&I found.)

Verizon booked the highest pension income of the 100 funds researched, at $2.7 billion, while using a 9.3% expected rate of return on plan assets in 2001. This surplus then showed up as 692% of Verizon's net corporate income, an extreme that provoked a shareholder resolution calling for the company to exclude pension income from corporate earnings (P&I, April 15).

The average compensation increase assumption was 4.2%, P&I found. The average discount rate for obligations was 7.2%, a figure tied into long-term debt ratings.

A slight change to the discount rate has a negligible effect on pension expenses, noted Jeremy Gold, an independent New York-based actuary.

LOAD-DATE: July 12, 2002

Expectations

Continued from page 3

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HIGH HOPES

The sponsors of the 100 largest corporate defined benefit funds, ranked by expected long-term rate of return on assets for 2001. The S&P 500 finished 2001 at -11.88%. Dollars are in millions.

Rank	Company	Expected return on assets	Fair value of plan assets	Benefit obligation	Funded status	Assets as % of benefit obligation	Net pension income or cost	Pension income as % of net corp. income	Benefit obligation as % of shareholder equity
1.	Weyerhaeuser	11.0%	$3,699.0	$2,869.0	$830.0	128.9%	$234.0	66.1%	42.9%
2.	FedEx[1]	10.9%	$5,622.0	$5,383.9	$238.1	104.4%	-$60.3	-10.3%	91.2%
3.	Eli Lilly	10.5%	$3,182.1	$3,598.7	-$416.6	88.4%	-$45.2	-1.6%	49.9%
4.	Northwest Airlines	10.5%	$4,399.0	$6,674.0	-$2,275.0	65.9%	-$231.0	54.6%	1,548.5%
5.	First Energy-GPU	10.3%	$3,483.7	$3,547.9	-$64.2	98.2%	$23.8	3.7%	48.0%
6.	DaimlerChrysler	10.1%	$22,655.8	$22,668.9	-$13.1	99.9%	-$439.5	74.6%	65.3%
7.	Bank of America	10.0%	$8,264.0	$7,606.0	$658.0	108.7%	$62.0	0.9%	15.6%
8.	Bristol-Myers Squibb	10.0%	$3,508.0	$3,914.0	-$406.0	89.6%	-$77.0	-1.5%	36.5%
9.	Delphi Automotive	10.0%	$6,077.0	$8,444.0	-$2,367.0	72.0%	-$233.0	63.0%	345.2%
10.	Delta Air Lines[2]	10.0%	$8,304.0	$10,657.0	-$2,353.0	77.9%	$73.0	-6.0%	282.8%
11.	El Paso[3]	10.0%	$2,479.0	$1,966.0	$513.0	126.1%	$54.0	58.1%	21.0%
12.	FleetBoston	10.0%	$2,304.0	$2,152.0	$152.0	107.1%	$15.0	1.6%	12.2%
13.	General Motors	10.0%	$67,322.0	$76,383.0	-$9,061.0	88.1%	-$146.0	24.3%	387.6%
14.	Goodyear	10.0%	$4,176.0	$5,215.0	-$1,039.0	80.1%	-$138.2	67.9%	182.1%
15.	Honeywell	10.0%	$11,051.0	$10,952.0	$99.0	100.9%	$310.0	-313.1%	119.4%
16.	IBM	10.0%	$39,565.0	$38,609.0	$956.0	102.5%	$1,025.0	13.3%	163.5%
17.	International Paper	10.0%	$6,502.0	$6,419.0	$83.0	101.3%	$141.0	-11.7%	62.4%
18.	Marsh & McLennan	10.0%	$2,316.0	$2,307.0	$9.0	100.4%	$42.0	4.3%	44.6%
19.	Merck	10.0%	$2,864.5	$3,611.8	-$747.3	79.3%	-$147.8	-2.0%	22.5%
20.	New York Life	10.0%	$2,637.0	$2,425.0	$212.0	108.7%	$46.0	4.2%	N/A
21.	Owens-Illinois	10.0%	$2,744.0	$2,520.6	$223.4	108.9%	$97.0	27.2%	117.1%
22.	Pfizer	10.0%	$5,648.0	$6,956.0	-$1,308.0	81.2%	-$169.0	-2.2%	38.0%
23.	Unisys	10.0%	$4,300.0	$3,869.0	$431.0	111.1%	$171.6	-255.7%	183.1%
24.	Wachovia-First Union[3]	10.0%	$3,221.0	$3,266.0	-$45.0	98.6%	$16.0	1.0%	16.2%
25.	Navistar[4]	9.9%	$2,872.0	$3,384.0	-$512.0	84.9%	-$46.0	200.0%	300.3%
26.	NCR	9.8%	$3,775.0	$3,621.0	$154.0	104.3%	$124.0	57.1%	178.6%
27.	PepsiCo	9.8%	$3,129.0	$3,556.0	-$427.0	88.0%	-$83.0	-3.1%	41.1%
28.	United Airlines	9.8%	$7,575.0	$10,095.0	-$2,520.0	75.0%	-$432.0	20.1%	332.8%
29.	Caterpillar	9.7%	$8,481.0	$8,611.0	-$130.0	98.5%	$163.0	10.1%	559.5%
30.	Deere[4]	9.7%	$5,951.0	$6,440.0	-$489.0	92.4%	-$85.0	132.8%	161.3%
31.	Electronic Data Systems	9.7%	$3,585.0	$3,943.0	-$358.0	90.9%	-$142.0	-10.4%	61.2%
32.	ITT Industries	9.6%	$3,233.5	$3,617.0	-$383.5	89.4%	$9.1	3.3%	262.9%
33.	United Technologies[8]	9.6%	$10,025.0	$12,354.0	-$2,329.0	81.1%	-$123.0	-6.3%	147.6%
34.	Alcoa	9.5%	$8,434.0	$8,488.0	-$54.0	99.4%	$33.0	3.6%	80.0%
35.	Allstate Insurance	9.5%	$2,532.0	$3,225.0	-$693.0	78.5%	$6.0	0.5%	18.8%
36.	American Airlines	9.5%	$5,482.0	$7,422.0	-$1,940.0	73.9%	-$512.0	29.1%	138.1%
37.	AT&T	9.5%	$18,485.0	$14,035.0	$4,450.0	131.7%	$246.0	3.2%	27.2%
38.	Bank One	9.5%	$2,747.0	$2,297.0	$450.0	119.6%	$14.0	0.5%	11.4%
39.	Bethlehem Steel[6]	9.5%	$4,753.0	$6,495.0	-$1,742.0	73.2%	-$103.0	5.3%	386.5%
40.	Citigroup	9.5%	$8,224.0	$7,823.0	$401.0	105.1%	$39.0	0.3%	9.6%
41.	Dana	9.5%	$2,283.0	$2,549.0	-$266.0	89.6%	$9.0	-3.0%	130.2%
42.	Disney[7]	9.5%	$2,450.0	$2,131.0	$319.0	115.0%	N/A	N/A	9.4%
43.	Dominion Resources	9.5%	$3,352.0	$2,593.0	$759.0	129.3%	$62.0	11.4%	31.0%
44.	DuPont	9.5%	$17,923.0	$18,769.0	-$846.0	95.5%	$374.0	8.6%	129.9%
45.	Eastman Kodak	9.5%	$6,317.0	$5,657.0	$660.0	111.7%	$157.0	206.6%	195.5%
46.	Exelon	9.5%	$6,279.0	$7,101.0	-$822.0	88.4%	$74.0	5.2%	86.3%
47.	Exxon Mobil	9.5%	$5,415.0	$8,213.0	-$2,798.0	65.9%	-$145.0	-0.9%	11.2%
48.	Ford Motor	9.5%	$35,819.0	$35,223.0	$596.0	101.7%	$346.0	-6.3%	452.4%
49.	General Electric	9.5%	$45,006.0	$30,423.0	$14,583.0	147.9%	$2,095.0	15.3%	55.5%
50.	Georgia-Pacific	9.5%	$3,711.0	$3,866.0	-$155.0	96.0%	-$17.0	3.6%	78.8%
51.	John Hancock Financial Services	9.5%	$2,292.8	$2,009.7	$283.1	114.1%	$76.0	12.3%	34.3%
52.	Kaiser Permanente - Kaiser Foundation Health Plan	9.5%	$4,900.0	$2,000.0	$2,900.0	245.0%	-$18.0	-2.6%	N/A
53.	Lockheed Martin	9.5%	$20,300.0	$19,713.0	$587.0	103.0%	$354.0	-33.8%	306.0%
54.	Northrop Grumman	9.5%	$13,889.0	$12,404.0	$1,485.0	112.0%	$337.0	78.9%	167.8%
55.	Pactiv[8]	9.5%	$3,561.0	$3,390.0	$171.0	105.0%	$113.0	58.5%	200.7%
56.	J.C. Penney[9]	9.5%	$3,074.0	$3,064.0	$10.0	100.3%	-$30.0	-30.6%	50.0%
57.	Prudential[3]	9.5%	$8,629.0	$6,607.0	$2,022.0	130.6%	$457.0	-296.8%	32.3%
58.	Raytheon	9.5%	$10,164.0	$11,171.0	-$1,007.0	91.0%	$286.0	-37.5%	98.9%
59.	SBC Communications	9.5%	$32,715.0	$25,060.0	$7,655.0	130.5%	$1,460.0	20.0%	77.1%
60.	Sprint	9.5%	$2,996.0	$3,005.0	-$9.0	99.7%	$48.0	-3.4%	23.8%
61.	TRW	9.5%	$2,976.0	$3,609.0	-$633.0	82.5%	-$100.0	-147.1%	165.1%
62.	United Parcel Service[5]	9.5%	$6,496.0	$5,347.0	$1,149.0	121.5%	$30.0	1.3%	52.2%
63.	US Airways	9.5%	$3,142.0	$5,486.0	-$2,344.0	57.3%	-$200.0	9.4%	209.8%
64.	Xcel	9.5%	$3,267.6	$2,409.2	$858.4	135.6%	$153.7	19.3%	38.9%
65.	Qwest	9.4%	$11,121.0	$9,625.0	$1,496.0	115.5%	$360.0	-8.9%	26.3%
66.	Aetna[8]	9.3%	$3,301.5	$3,580.6	-$279.1	92.2%	$37.0	-13.2%	36.2%
67.	AK Steel	9.3%	$2,941.7	$3,341.4	-$399.7	88.0%	-$136.0	147.2%	923.4%
68.	Boeing[3]	9.3%	$33,810.0	$32,693.0	$1,117.0	103.4%	$322.0	-21.2%	302.0%
69.	Duke Energy	9.3%	$2,470.0	$2,528.0	-$58.0	97.7%	$9.0	0.5%	19.9%
70.	J.P. Morgan Chase-Chase Manhattan	9.3%	$4,048.0	$4,007.0	$41.0	101.0%	-$113.0	-6.7%	9.7%
71.	Textron	9.3%	$4,480.0	$3,908.0	$572.0	114.6%	$96.0	57.8%	99.3%
72.	Verizon	9.3%	$48,558.0	$36,391.0	$12,167.0	133.4%	$2,690.0	691.5%	111.8%
73.	Wyeth	9.3%	$2,738.6	$3,316.0	-$577.4	82.6%	-$74.9	-3.3%	81.4%
74.	Consolidated Edison	9.2%	$6,633.7	$5,904.3	$729.4	112.4%	$314.2	45.2%	104.2%
75.	Kimberly-Clark	9.2%	$3,721.5	$4,014.6	-$293.1	92.7%	$19.6	1.2%	71.1%
76.	Dow Chemical	9.2%	$11,424.0	$11,341.0	$83.0	100.7%	$95.0	-10.6%	113.5%
77.	American Electric	9.0%	$3,438.0	$3,292.0	$146.0	104.4%	$69.0	7.1%	40.0%
78.	BellSouth	9.0%	$16,617.0	$11,928.0	$4,689.0	139.3%	$797.0	31.0%	64.1%
79.	CIGNA	9.0%	$2,500.0	$2,932.0	-$432.0	85.3%	-$69.0	-7.0%	58.0%
80.	Johnson & Johnson	9.0%	$4,355.0	$5,026.0	-$671.0	86.6%	-$74.0	-1.3%	20.7%
81.	Lucent Technologies[7]	9.0%	$35,539.0	$29,850.0	$5,689.0	119.1%	-$1,090.0	6.7%	270.8%
82.	3M	9.0%	$6,053.0	$6,553.0	-$500.0	92.4%	$39.0	2.2%	107.7%
83.	Motorola	9.0%	$2,957.0	$3,293.0	-$336.0	89.8%	-$129.0	3.3%	24.1%
84.	Philip Morris	9.0%	$9,448.0	$8,818.0	$630.0	107.1%	$211.0	2.5%	44.9%
85.	Public Service Ent. Group	9.0%	$2,227.8	$2,675.5	-$447.7	83.3%	-$57.7	-31.5%	120.3%
86.	Sears, Roebuck	9.0%	$2,349.0	$3,091.0	-$742.0	76.0%	-$68.0	-9.3%	50.5%
87.	Wells Fargo	9.0%	$2,761.0	$2,934.0	-$173.0	94.1%	$49.0	1.4%	10.8%
98.	MetLife	8-9.0%	$4,161.0	$4,426.0	-$265.0	94.0%	-$29.0	-6.1%	27.6%
88.	Nationwide Financial	8.0%	$2,200.7	$2,132.2	$68.5	103.2%	-$28.7	21.8%	61.9%
89.	ChevronTexaco	8.8%	$4,400.0	$5,180.0	-$780.0	84.9%	-$144.0	-4.4%	15.3%
90.	Westvaco[10]	8.8%	$2,542.3	$1,361.6	$1,180.7	186.7%	$134.9	152.9%	58.2%
91.	PG&E	8.5%	$7,175.0	$6,087.0	$1,088.0	117.9%	-$125.0	11.4%	140.8%
92.	Sandia	8.5%	$3,063.6	$1,495.0	$1,568.6	204.9%	$125.5	N/A	N/A
93.	Southern Calif. Edison	8.5%	$2,723.0	$2,327.0	$396.0	117.0%	-$13.0	-0.5%	74.0%
94.	Southern Co.	8.5%	$5,109.0	$3,760.0	$1,349.0	135.9%	$124.0	9.8%	47.1%
95.	Viacom	8.3%	$4,566.0	$5,099.7	-$533.7	89.5%	-$26.4	11.8%	8.1%
96.	General Dynamics	8.2%	$6,107.0	$5,162.0	$945.0	118.3%	$33.0	3.5%	114.0%
97.	Sempra Energy	8.0%	$2,449.0	$2,010.0	$439.0	121.8%	$15.0	2.9%	74.7%
99.	Shell Oil	7.8%	$36,420.0	$32,239.0	$4,181.0	113.0%	$756.0	7.0%	2,671.0%
100.	FPL Group[3]	7.8%	$2,546.0	$1,353.0	$1,193.0	188.2%	$110.0	14.1%	22.5%

[1]YEAR ENDED MAY 31, 2001. [2]EXPECTED RATE OF RETURN ON PLAN ASSETS FOR YEAR ENDED SEPT. 30, 2001; ALL OTHER DATA FOR YEAR ENDED DEC. 31, 2001. [3]PENSION DATA, EXCEPT NET PENSION COST, FOR YEAR ENDED SEPT. 30, 2001; NET PENSION COST AND CORPORATE DATA FOR YEAR ENDED DEC. 31, 2001. [4]YEAR ENDED OCT. 31, 2001. [5]NET PENSION INCOME -COST) INCLUDES MULTIEMPLOYER AND SALARIED PLANS. [6]PENSION DATA FOR YEAR ENDED NOV. 30, 2001; CORPORATE DATA FOR YEAR ENDED DEC. 31, 2001. [7]YEAR ENDED SEPT. 30, 2001. [8]PENSION DATA FOR YEAR ENDED SEPT. 30, 2001; CORPORATE DATA FOR YEAR ENDED DEC. 31, 2001. [9]EXPECTED RATE OF RETURN ON PLAN ASSETS FOR YEAR ENDED OCT. 31, 2001; ALL OTHER DATA FOR YEAR ENDED JAN. 26, 2002. [10]PENSION DATA FOR YEAR ENDED JULY 31, 2001; CORPORATE DATA FOR YEAR ENDED OCT. 31, 2001.

Pensions and Investments

August 19, 2002, Monday

SECTION: Pg. 1

LENGTH: 991 words

HEADLINE: ROSY ASSUMPTIONS: Beware of 'pension time bomb,' Connell tells funds ; CalPERS and CalSTRS urged against investing in firms that pad bottom line

BYLINE: Joel Chernoff

BODY:

SACRAMENTO, Calif. - California State Controller Kathleen Connell is urging CalPERS and CalSTRS to stop investing in companies that pad their bottom line by using overly optimistic pension fund return assumptions.

With some U.S. companies using rate of return assumptions north of 10%, Ms. Connell warned of ''a pension time bomb,'' terming the use of inflated pension fund return assumptions as ''accounting gimmickry that has to end.''

The U.S. Securities and Exchange Commission should establish guidelines for what is a reasonable rate of return, the Democratic controller said. She added pension surpluses should not contribute to the corporate bottom line and earnings, as they now do under Financial Accounting Standard 87.

''The last thing we need are any more surprises on the corporate landscape,'' she added, referring to accounting scandals at Global Crossing Ltd., Enron Corp. and WorldCom Inc.

If a company uses unrealistic assumptions and then later gets into financial trouble, the effect will be to lower earnings and hurt its share price, thus hurting investors. She said she would like to see the $140 billion California Public Employees' Retirement System and the $97 billion California State Teachers' Retirement System, both in Sacramento, get ''ahead of the pack'' by tackling the issue.

Standing fast

Top corporate executives are sticking with pension fund return assumptions. In recent certifications of their financial statements to the SEC, chief executives and chief financial officers of the companies with the top five highest return assumptions for the pension funds certified to their accuracy. Those companies are: Weyerhaeuser Co., projecting an 11% return; FedEx Corp., 10.9%; Northwest Airlines Inc., 10.5%; and First Energy Corp. and Eli Lilly & Co., both 10.3%.

Ms. Connell, whose term expires in January, appears to have touched a nerve. Michael Flaherman, chairman of CalPERS' investment committee, said the controller has raised ''potentially a very significant issue.'' He said CalPERS' first-hand knowledge of setting return assumptions gives fund officials expertise in this area, although he believes CalPERS would have more clout as a shareholder by staying invested in companies than by divesting their stock.

Sherry Reser, a spokeswoman for CalSTRS, said the issue would be discussed at the fund's Oct. 2 investment committee meeting.

Congress also is concerned. Rep. George Miller, D-Calif., ranking member of the House Education and Workforce Committee, and Rep. Rob Andrews, D-N.J., ranking member of the subcommittee on employer-employee relations, have called for hearings on the security of private pension plans. While the legislators are worried about growing unfunded pension liabilities - which more than quadrupled in the past year to $111 billion, according to the Pension Benefit Guaranty Corp. - part of their concern stems from aggressive rate of return assumptions.

Public fund demands

Meanwhile, other public pension officials are eager to restore investor confidence. Last week, pension officials from 17 states and the District of Columbia met in New York City, demanding greater corporate integrity and strengthened accountability to investors.

The meeting was called by California state Treasurer Philip Angelides, New York Comptroller H. Carl McCall and North Carolina Treasurer Richard Moore. The pension officials discussed adopting principles to eliminate conflicts of interests between Wall Street analysts and investment banks, mobilizing major shareholders to ensure recent financial reforms are implemented and enforced, and condemning the practice by some U.S. companies to move their headquarters off-shore to avoid taxes.

In an interview, Ms. Connell said companies with high return assumptions - particularly where pension income accounts for more than 50% of corporate net income - are themselves ''highly risky investments for a pension fund like PERS or STRS.''

In a later conversation, she clarified that pension assumptions should be one of many criteria used in evaluating stocks, but if companies fail to adopt reasonable assumptions over a set time period, say, 18 months, then CalPERS and CalSTRS should divest their shares of such companies.

High returns

A survey issued this spring by Milliman USA, Seattle, revealed that 50 of the largest U.S. corporations have continued to employ high return assumptions for their pension funds despite the battering markets took in 2001. The average expected rate of return last year was 9.39%, virtually the same rate used in 2000.

Strikingly, that return assumption would have produced an aggregate $54 billion gain last year. In reality, those corporate funds lost $36 billion - a swing of more than $90 billion that is bound to hit 2002 earnings, the survey notes. ''Even with asset smoothing, we expect most of the $9.6 billion in pension income for 2001 will be erased in 2002,'' a Milliman release noted. Nearly 90% of pension plan surpluses have evaporated in the past two years, the firm observed.

Ms. Connell's criticisms of high projected rates of return also strike close to home. In a letter to CalSTRS Board Chairman Gary Lynes, she questioned CalSTRS' own 8% return assumption, seeking justification for any return assumption greater than 7%. In the interview, Ms. Connell said she might be open to a compromise figure of 7.5%.

CalPERS, which is going to review its capital-market assumptions later this week,assumes an 8.25% return.

Ms. Connell also wants the teachers' retirement system - which has slipped from $9.1 billion in overfunding to $2.2 billion in the red during the past two years - to adopt annual actuarial valuations instead of biennial measures, and to conduct an annual review of its expected rate of return. CalSTRS now revisits its assumptions once every four years.

Ricki Fulman and Vineeta Anand contributed to this article.

GRAPHIC: California State Controller Kathleen Connell called inflated pension fund return assumptions "accounting gimmickry that has to end."

LOAD-DATE: August 22, 2002

Financial Times (London)

August 30, 2002, Friday London Edition 1

SECTION: COMPANIES & FINANCE THE AMERICAS; Pg. 26

LENGTH: 419 words

HEADLINE: Pension funds may act over inflated returns

BYLINE: By JULIE EARLE

DATELINE: NEW YORK

BODY:

US pension funds are considering a crackdown on companies that inflate their earnings by using too high pension fund return assumptions.

Calpers, the number one pension fund, and its sister fund Calstrs, are weighing up whether to assess high-return assumptions on other companies' pension funds, as part of their investing strategy.

Companies like Weyerhaeuser, the forest products group, Delta Airlines, General Motors and Ford have stuck with their high pension fund return assumptions, in spite of the sinking stock market.

If companies do not make their assumed pension fund returns, they would then need to make up the difference.

Any earnings revisions are likely to harm companies' share prices.

"In many corporations in America, pension income has been a substantial part of revenue growth in the past three years," said Kathleen Connell, California's state controller and a board member of Calpers and Calstrs.

"If you subtract pension earnings, you end up with an entirely different value for share prices. These are phantom earnings," she said.

A 2002 study of 50 of the largest pension plans by Milliman USA, a Seattle-based actuarial firm, shows the average rate of return on assets for 2001 was 9.3 per cent, producing an expected return of Dollars 54bn.

The actual returns, however, were a negative Dollars 36bn, a loss of more than Dollars 90bn.

Ms Connell wants Calpers and Calstrs to assess too high pension fund return assumptions as part of their investing strategy. Both funds have said they will discuss the issue, but the process is likely to be a lengthy one.

The funds are already assessing an overhaul of stock option accounting and whether to ban investing in companies that relocate to offshore tax havens.

Ms Connell said pension fund investors, hit hard by losses on accounting scandals like WorldCom and Enron, did not need any more pain.

In some cases, companies' pension income accounted for more than 50 per cent of corporate net income, she said.

General Motors and IBM both assume they can earn 10 per cent a year on their pension reserves. In GM's case, 60 per cent of the pension fund is invested in equities.

Warren Buffett, the investment guru, has warned for some time that fund managers' long-term return assumptions for equities are "delusional".

Ms Connell said pension fund return earnings would not be reason alone for investing or divesting in a company's stock, but part of the funds' due diligence in reviewing companies.

LOAD-DATE: August 30, 2002

USA TODAY

September 5, 2002, Thursday, FINAL EDITION

SECTION: MONEY; Pg. 1B

LENGTH: 455 words

HEADLINE: Pension revenue can mislead investors

BYLINE: Christine Dugas

BODY:
Phantom pension revenue is coming under fire as critics complain that pension accounting rules can mislead investors about the financial health of many companies.

"If stock options were the accounting issue of 2002, then there's a good chance that pension accounting will be the issue of 2003," says David Blitzer, managing director at Standard & Poor's.

Companies in the S&P 500 with pension plans said they accounted for 8.2% of operating revenue last year, according to Morgan Stanley. But pension revenue wasn't really that high.

Accounting rules allow companies to report expected rates of return on pension assets, not actual returns. And though the bear market has dragged down returns, many assumptions haven't changed.

Pension assets of S&P 500 companies on average declined 6.9% last year, yet they used an average growth rate of 9.2% to calculate pension revenue in financial statements.

Pension problems are growing. This week, for instance, auto stocks fell 6% in one day after a UBS Warburg report focused on how underfunded pensions are becoming a drain on cash flow at Ford Motor and General Motors. And a wave of corporate accounting scandals has turned attention to how accounting practices can inflate earnings.

Among the latest pension-related developments:

* S&P this month will introduce a "core earnings" measure that will strip away such things as pension revenue to better gauge corporate earnings.

* California State Controller Kathleen Connell has proposed that the giant state public pension plans, Calpers and Calstrs, stop investing in companies that use overly optimistic pension fund projections. She says they will take up the issue this month. "I think anything above 8.5% is suspect," she says.

* Shareholder groups introduced proposals aimed at excluding pension revenue from calculations used to determine executive incentive pay. At Verizon Communications, the measure failed but garnered 43% of votes. Verizon's pension assets declined by $ 3 billion in 2001, vs. a projected gain of $ 4.8 billion, according to Milliman USA.

Critics of pension accounting are not troubled only by unrealistic revenue projections. Many say that pension assets shouldn't be used to bolster the bottom line at all, because the money doesn't belong to shareholders and can't be used for operations. .

Rep. Rob Andrews, D-N.J., ranking Democrat on the House Subcommittee on Employer-Employee Relations, says the Securities and Exchange Commission should step up oversight of pension accounting.

A few companies are voluntarily addressing the issue. Berkshire Hathaway, for example, will cut its projected return to 6.5% from 8.3% last year.

LOAD-DATE: September 05, 2002

Los Angeles Times

September 5, 2002 Thursday Home Edition

SECTION: Main News Main News; Part 1; Page 1; Metro Desk

LENGTH: 1449 words

HEADLINE: Pensions Straining Civic Coffers;
Finance: As stocks fall, some municipalities cut services in order to fund retirement plans. Bills on Gov. Davis' desk may push costs even higher.

BYLINE: CATHERINE SAILLANT, TIMES STAFF WRITER

BODY:

Generous retirement plans for California public employees, approved during the 1990s stock boom, now threaten to burden state and local governments with huge new debts as the stock market declines.

In 1999 and 2001, Gov. Gray Davis signed legislation--backed by unions for police officers, firefighters and other public employees--that allowed local governments to negotiate pension increases of up to 50%.

Davis' administration granted better retirements to members of the California Highway Patrol and other state workers. Under pressure from unions--and buoyed by high stock prices that had fattened pension funds--more than half the state's local governments did so as well. Some of the contracts provide pension benefits of up to 100% of a retired worker's salary.

Now the bills for the higher benefits are starting to come due even as the declining stock market has reduced the value of state pension funds by 5% to 10% over the last year. The state government's bill for its workers has doubled in the last year to $1.2 billion. On the local level, the California Public Employees' Retirement System sent a letter to city administrators in June warning that benefit payments by many cities could rise by 20% over the next two years.

CalPERS invests pension funds and pays benefits on behalf of the state and local governments. Because the benefits are guaranteed, if the return on pension funds falls short, local governments must make payments from general tax funds to cover what they have promised.

That is what is now happening in Contra Costa County in the Bay Area. Officials there expect to cut $17 million from programs and services this year and $37 million next year to pay for worker benefits.

"Every single county department has been hit," said John Sweeten, a Contra Costa County administrator.

Monterey County's pension payment rose from zero to $6 million for law enforcement employees this year. That is about 26% of payroll. The debt is expected to peak at 30% of payroll by 2007, which would force serious reductions in county services, said County Administrative Officer Sally Reed.

The effects won't be felt in Los Angeles because county and city leaders haven't approved pension increases. But dozens of other local governments--including Orange, Riverside and San Diego counties and the cities of Oxnard, Long Beach, Anaheim and Garden Grove--are bracing for steeply higher costs.

The changes in Orange County's pension benefits illustrate the changes. Under the old system, a sheriff's deputy with 30 years' experience could retire and receive at least 60% of his pay. Under the new system, he would receive benefits equal to at least 90%.

Critics of the new benefits say the unions' financial support for Davis and labor's nearly nonstop lobbying of the Democratic majority in the state Legislature opened the door to fiscally unsound decisions by local governments.

Labor groups have given Davis at least $9.7 million since 1999, with more than a quarter of that amount coming from public employee unions whose members have benefited from the enhanced retirement packages.

A Davis spokesman said labor's financial support played no role in his decision to sign the legislation, and noted that both bills had broad legislative support. Indeed, the bills passed the Legislature on lopsided votes with little public debate.

Public employees were asked to sacrifice during the down times of the 1990s, and the pension bills were designed to "make up for the many, many years they were neglected," spokesman Steve Maviglio said. "We do these things so we can keep and retain employees and remain competitive. I wouldn't characterize them as excessive."

California's pension benefits for public safety employees are substantially higher than the average among the states, according to figures from the National Assn. of State Retirement Administrators in Washington, D.C.

Regardless of the motivation, passage of the legislation has set off political fights across the state over benefit levels.

A CalPERS spokeswoman, Pat Macht, said cities and counties had been given full disclosure about the effect of approving the higher benefits for employees.

"No one twisted their arms," Macht said. "The Legislature allowed the opportunity if it seemed appropriate. Any increase in benefits was fully analyzed and provided to their staffs."

But once the first city approved the pension increases, "the pressure to do the same was enormous," said Long Beach City Manager Henry Taboada. "It was a feeding frenzy."

Often, public employee unions are in a strong position to put pressure on county or city officials sitting across the table from them in bargaining sessions.

For example, in 2001, Ventura County supervisors resisted increasing pensions for sheriff's deputies. The board's refusal to grant the benefit increase almost cost Supervisor Judy Mikels, who represents the Simi Valley area, her seat. Union members picketed Mikels' campaign events and backed her opponent, a former Los Angeles police officer.

Mikels, a two-term incumbent, squeaked by with 51% of the vote. After 18 months, the deputies union gave up and accepted a contract that does not include the higher retirement benefits.

Mikels, a Republican who had been one of law enforcement's closest allies on the board until the benefit issue arose, called the proposed pension increases "obscene."

Critics of the pension increases argue that retirement plans for public employees already were more generous, and more secure, than the up-and-down 401(k) plans increasingly offered by private sector employers.

"How many people have been able to retire at 50, period, let alone get most of their salary?" said Dave Thompson, legislative consultant for the Los Angeles County Sanitation Districts. "It does exactly what you don't want to do as an employer: It encourages people to leave early."

But union officials say public employers must offer improved benefits to attract good men and women.

For people like police officers, the job is often difficult and sometimes fatal. When officers have a choice, they will go with an agency that will guarantee them an early and livable retirement, said Clancy Faria, president of the Police Officers Research Assn. of California, based in Sacramento.

"Recruits today are very savvy about what's out there," Faria said. "They shop areas for cost of living, housing, salary and retirement benefits."

Moreover, some public employees don't get Social Security, noted Terry Brennand, a lobbyist for the Service Employees International Union. Government officials weren't complaining in the late 1990s when the stock market carried pension funds so high that local governments were not required to make any payments at all, he said.

"I don't have a lot of empathy for them," he said. "When they had excess dollars, nobody set any money aside. Nobody planned for the future."

Meanwhile, public employee unions have succeeded in pushing several new bills through this year's legislative session that could raise costs further.

* SB 1024 and SB 1409 would allow police and firefighters to "retire" but continue working for as long as five years, earning a salary during those years and collecting retroactive retirement pay for that period when it ends.

* AB 2023 would allow state and local prosecutors and deputy public defenders to be classified as safety employees, allowing them to negotiate for pension benefits greater than they currently are allowed.

* AB 2792 would eliminate local government's ability to reduce or modify benefits, without employees' consent, for newly hired employees. That bill would eliminate one potential avenue for local governments to help remedy their current problem by cutting back on pensions for newly hired employees.

All four measures have been approved by the Legislature and are awaiting Davis' signature.

The current problem, meanwhile, is only likely to worsen, pension experts say. The steepest increases in payments won't be seen until next year because it takes two years for the stock market's performance to show up in pension bills, said Dallas Salisbury, president of the Employee Benefit Research Institute, a

Washington-based organization financed by employers, unions and government agencies.

"If you increase benefits based on short-term market factors, and those factors suddenly reverse, the cost quickly catches up with you," Salisbury said. "I always say be cautious with benefits. What you think you have today could go away tomorrow."

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Times staff writer Dan Morain in Sacramento contributed to this report.

LOAD-DATE: September 5, 2002

MILLIMAN USA

2002 Study of 50 of the Largest Pension Plans

An examination of the 2001 annual reports of 50 of the largest U.S. corporations revealed the following about the funded status of their defined benefit pension plans and the impact of those plans on corporate earnings:

- **The funded status of the plans have drastically declined as a result of investment results in 2000 and, more tellingly, 2001.**
  - Surplus assets declined by $100 billion in 2001
  - Almost 90% of the plans' surplus has evaporated over a 2-year period (from 1999-2001), over a $140 billion loss.
  - 28 out of the 50 companies surveyed in 2001 were in a deficit position (9 in excess of $1 billion) compared to 8 out of the 50 in 1999 (none over $1 billion)

- **The expected rates of return on the assets for 2001 were optimistically high.**
  - Expected rates of return, despite lower actual rates of return in 2000, generally stayed the same for 2001 and, in 8 cases, actually increased.
  - The average rate of return for 2000 was 9.38 % – expected return exceeded $51 billion, actual return was less than $14 billion
  - For 2001, the average rate of return was 9.39% producing expected return of over $54 billion. Actual returns for 2001 added up to a negative $36 billion, a loss of over $90 billion.

- **Pension Income for 2001 not impacted by asset losses**
  - Pension income for 2001 actually increased ($9.2 to $9.6 billion for the 50 companies combined), in spite of a $38 billion asset loss in 2000
  - From the data collected, it appears that at least 22 out of the 50 companies studied are using some sort of asset smoothing methodology. For these companies, pension income increased from $4.3 billion (1999) to $8.2 billion (2000) to $9.4 billion (2001).
  - The $90 billion asset loss in 2001 will impact 2002 earnings. Even with asset smoothing, we expect most of the $9.6 billion in pension income for 2001 will be erased in 2002.

- **Companies are being pressured to lower expected rates of return for 2002**
  - Two years of losses, coupled with smaller equity positions and the predictions by some investment professionals of lower long term equity returns are producing lower expected returns for 2002
  - Auditors, in the post-Enron environment, are questioning the level of expected returns used in the past
  - Reducing expected return by 1% would have reduced 2001 corporate earnings by $5.7 billion for these 50 companies.